

No. 7727

**In the United States Circuit Court of
Appeals for the Ninth Circuit**

WILLIAM C. KOTTEMANN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS*

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The sole previous opinion in this case is the unpublished memorandum opinion which was rendered by the Board of Tax Appeals on March 6, 1934 (R. 28-36).

JURISDICTION

This petition for review involves income taxes for the year 1927, and is taken from the decision of the Board of Tax Appeals entered on April 27, 1934 (R. 36-37). The case is brought to this Court

by petition for review filed July 23, 1934 (R. 37-45), pursuant to the provisions of Sections 1001-1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

QUESTION PRESENTED

Whether under the circumstances present in this case the petitioner is entitled to a deduction for the year 1927 of the entire amount of a \$20,000 attorney fee contracted in that year, or whether he is limited to the deduction of only \$3,500 thereof actually accrued and paid during said year.

STATUTE AND OTHER AUTHORITIES INVOLVED

The Revenue Act of 1926, c. 27, 44 Stat. 9, provides in part as follows:

SEC. 200. When used in this title—

* * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a differ-

ent period. * * * (U. S. C. App., Title 26, Sec. 931.)

SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * * (U. S. C. App., Title 26, Sec. 953).

SEC. 214. (a) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *. (U. S. C. App., Title 26, Sec. 955.)

The Rules of Practice of the Board of Tax Appeals provide in part as follows:

RULE 5.—INITIATION OF A PROCEEDING—
PETITION.

A proceeding shall be initiated by filing with the Board a petition * * *. It shall contain:

* * * * *

(d) Clear and concise assignments of error alleged to have been committed by the Commissioner. Such assignments of error shall be numbered.

* * * * *

(f) A prayer, setting forth relief sought by the petitioner.

* * * * *

STATEMENT

The memorandum opinion of the Board discloses that it was a single opinion rendered in five separate proceedings, brought separately by two taxpayers for the redetermination of their respective deficiencies, for different years, as follows (R. 28) :

William C. Kottemann (the petitioner in the present appeal) had brought proceedings to redetermine deficiencies as indicated below :

B. T. A. Docket No.—		
45929	-----	1927
61238	-----	1928
61239	-----	1929

Bertha M. Kottemann, his wife, had brought proceedings to redetermine deficiencies as follows :

B. T. A. Docket No.—		
61240	-----	1928
61241	-----	1929

Pursuant to its memorandum opinion the Board entered separate final decisions in each of the five proceedings, and in B. T. A. Docket No. 45929 found that there was an overpayment for the year 1927 in the amount of \$986.21 ¹ (R. 36-37).

William C. Kottemann, by his petition for review herein, has appealed to this Court from the separate decision entered by the Board in Docket No. 45929 involving the year 1927. The present

¹ The petitioner both in his petition for review (R. 43, 44) and in his brief (p. 8) refers to the amount of overpayment for 1927 found by the Board as \$878.06, while from the record (p. 37) the correct amount appears to be \$986.21.

appeal therefore involves only the one proceeding, B. T. A. Docket No. 45929, for the redetermination of the deficiency against him for the year 1927 (R. 37-45).

Insofar as material to the present appeal, the facts may be stated briefly as follows, from the findings made by the Board:

The petitioner, a resident of Los Angeles, California, was for many years before and after 1927 engaged in the practice of public accounting, being licensed as a certified public accountant in the States of New York and California. Except as hereinafter noted, he kept his books of account and records, and filed his income tax returns on the accrual basis (R. 29).

During the year 1927 petitioner was employed to make an audit of the brokerage firm of A. C. Wagy & Company, Inc., and of the capital stock records, stock books, etc., of the Julian Petroleum Corporation. The income due petitioner as a result of this employment was placed on his books currently as it accrued, and statements of the amounts due and owing from such sources were rendered to these two corporations accordingly. The audit of the Julian Petroleum Corporation was commenced on February 14, 1927, and was terminated on May 16, 1927 (R. 30).

The audit made by petitioner disclosed that the stock of Julian Petroleum Corporation had been overissued approximately six times, and shortly

after this exposure both corporations went into bankruptcy (R. 30).

Thereafter, petitioner, together with a large number of prominent people of the State of California (approximately 100), was indicted. Two charges were brought, one of conspiracy to violate the State Corporate Securities Act through the overissuance of Julian Petroleum Corporation stock, and the other to defraud the public through the sale of such stock. The indictment was issued against petitioner on June 24, 1927, and in order to defend himself he was compelled to employ attorneys to represent him. Under date of August 18, 1927, he entered into an agreement with the law firm of Scarborough & Bowen, of Los Angeles, wherein he agreed to pay for their services the sum of \$20,000 (R. 33).

Petitioner paid under this contract \$3,500 during the year 1927, \$3,500 in the year 1928, and \$6,500 in the year 1929. Petitioner took on his 1927 return a deduction of \$3,500, on his 1928 return \$3,500, and on his 1929 return the \$6,500 paid during that year, as well as the accrual of the \$6,500 still due under the contract. Petitioner was tried and acquitted, as were all of the other defendants who were tried at that time (R. 33).

Although petitioner reported on the accrual basis, he did not in 1927 accrue the entire sum of \$20,000 agreed to be paid under the contract, because he hoped to have part of the expenses assumed by others and undertook negotiations to this

end. In 1927 and 1928 he accrued and claimed as deductions only the sums actually paid, \$3,500 in each year. In 1929 he deducted \$6,500 paid in that year, and also accrued and deducted the unpaid balance of \$6,500 (R. 34).

The Commissioner disallowed the deduction of \$3,500 legal fees claimed for 1927 (as well as the deductions claimed in the other years) on the ground that the legal fees were paid for defending taxpayer, who was under indictment, and were therefore a personal expense (R. 22-23).

The petitioner appealed separately to the Board of Tax Appeals from the determination of the Commissioner for each of the three years in question. Other issues were presented to the Board in the three appeals by petitioner and in the two by his wife, and decided by the Board in its opinion, but they are not relevant to this appeal and need therefore not be referred to. On the question of the deductions of legal fees the Board held that the Commissioner had erred in disallowing the deductions for the sums of \$3,500, \$3,500, and \$6,500 accrued and paid in the years 1927, 1928, and 1929, respectively. The Board further held that the petitioner had erred in claiming the deduction for the balance of \$6,500 which he had accrued but not paid in 1929 (R. 33-34).

The petitioner appeals to this Court from the Board's decision in Docket No. 45929, which as has been seen concerns only the year 1927, and urges that the Board erred in holding that he was entitled

to deduct only \$3,500 in 1927 on account of the legal fees in question, and asserts now that he was entitled to deduct the entire \$20,000 in the year 1927.

SUMMARY OF ARGUMENT

This appeal involves only the redetermination of the deficiency asserted against petitioner for the year 1927. In his return for 1927, petitioner claimed a deduction of \$3,500 for legal fees which he had accrued and paid in that year. The Commissioner disallowed this deduction, and the petitioner appealed to the Board, asserting that the Commissioner erred in disallowing "as a deduction from his gross income the amount of certain legal fees paid by him" in 1927 (R. 5). The Board reversed the Commissioner and allowed the deduction of \$3,500 for 1927. By the decision of the Board, therefore, the petitioner obtained all the relief for which he prayed; he obtained all that he had sought in his appeal to the Board concerning the 1927 deficiency. His petition for review to this Court now raises a new issue, and seeks additional relief, by claiming that he was entitled to deduct the entire \$20,000 in 1927. This issue, not having been raised below, but being now raised for the first time on appeal, cannot be considered by this Court, and the decision of the Board should therefore be affirmed.

In addition to the foregoing, the decision of the Board should be upheld on the ground of equitable estoppel, or estoppel *in pais*.

ARGUMENT

As has been indicated, the present appeal is taken from the decision of the Board in Docket No. 45929, which involves the redetermination of the deficiency asserted against petitioner for the taxable year 1927. The record before the Court shows conclusively that the issue presented before the Board in this case (omitting, of course, the mention of other issues not relevant to the present appeal) was whether or not the petitioner was entitled to the deduction claimed by him in 1927 of the sum of \$3,500 for legal fees which he had accrued and paid in that year. The record establishes indisputably that the case before the Board did not involve or present the issue of whether or not the petitioner was entitled to accrue the entire \$20,000 legal fees in 1927, and that this issue is raised and presented *for the first time* in the appeal to this Court by the petition for review.

Tracing the history of this proceeding back to its very inception, it will be seen first that the return filed by William C. Kottemann for the taxable year 1927 asserted a claim to a deduction of the sum of \$3,500 accrued and paid by the taxpayer in that year on account of the legal fees herein involved. The next step is the action of the Commissioner, who, in determining a deficiency in tax for the year 1927 against William C. Kottemann, disallowed this deduction of \$3,500 claimed by the taxpayer, stating in his letter giving notice of the deficiency

that the legal fees paid were disallowed because the Commissioner regarded them as a personal expense. Next we find that the taxpayer appealed from that determination of a deficiency for the year 1927, by a petition to the Board of Tax Appeals, being Docket No. 45929.

In that petition to the Board the taxpayer asserted that in determining the deficiency (R. 5):

(a) The commissioner has erred in denying to the taxpayer the right to treat as a proper business expense and as a deduction from his gross income the amount of certain legal fees paid by him.

(b) The Commissioner has further erred in alleging that such legal expense was not a proper business deduction.

(c) The Commissioner has further erred in disallowing the deduction of that legal expense by not taking into consideration all of the facts, circumstances, and conditions directly or indirectly associated or connected with that expenditure for legal expense.

The foregoing are all the assignments of error set forth in the petition to the Board on the subject of the legal fees. Other assignments pertain to other matters and need not be mentioned here.

We find next the memorandum opinion of the Board, and its subsequent decision pursuant thereto. The Board stated that the Commissioner was in error in disallowing the deduction of the sums paid to the attorneys, and held that the taxpayer was entitled to the \$3,500 deduction claimed

in 1927 (and to the deduction of the amounts of \$3,500 and \$6,500 paid in 1928 and 1929, respectively). The Board accordingly recomputed the tax for 1927 and entered a final decision in Docket No. 45929 that there was an overpayment for the year 1927 in the amount of \$986.21.

It is clear from the foregoing, therefore, that the petitioner did not, in his appeal to the Board, raise the issue which he now raises in the appeal to this Court, *i. e.*, whether he was entitled to the deduction of the entire \$20,000 legal fees in the year 1927. It might be pointed out in this connection that petitioner is in error when he represents, in his petition for review addressed to this Court (R. 42) and in his brief (p. 3), that in his appeal to the Board he alleged that the Commissioner erred in denying him the right to deduct the \$20,000 legal fees. His petition in the Board of Tax Appeals did not assign as error the disallowance of a deduction of \$20,000; it only charged error as to the disallowance of a deduction of "the amount of certain legal fees *paid* by him" (R. 5, italics ours) in that year, and the amount paid is \$3,500. In order to raise the issue of the right to deduct the *entire* \$20,000 legal fees in 1927, it was incumbent upon the petitioner to place the matter before the Board by appropriate assignment of error to that effect, as is required by the Rules of Practice of the Board. (Rule 5 (d), *supra*.) But his petition contained no such assignment of error; nor did the first amended petition, which he

subsequently filed in this proceeding (R. 24-27), raise this issue. The new assignment of error set forth in the first amended petition does not refer to the subject matter of the legal fees at all. It is to be noted further that the petitioner closed his petition to the Board with the statement that he "confidently expected" that "those two disallowed items" (one item being the \$3,500 deduction, and the other being a deduction for bad debts) "will be allowed and *that the return as filed will be approved*" (R. 17, italics ours). The return, as has been stated, sought only the deduction of \$3,500 accrued and paid in 1927. Nothing more is said in the petition to the Board as to this item of legal fees. The formal prayer for relief merely asks that his appeal be heard and determined. The petition contains nothing which in any way suggests the issue of the right to a deduction of the entire \$20,000 in the year 1927.

It is evident, therefore, that this issue is raised for the first time in the petition for review filed in this Court, by an assignment of error to the effect that the Board erred in failing to allow as a deduction for the year 1927 the entire sum of \$20,000 legal fees.² (Assignment No. 1, R. 43.)

² In this connection we might point also to the fallacy of assignment of error No. 3 (R. 43), and to the argument advanced in petitioner's brief (p. 17), to the effect that if the Board is correct in its holding that only \$3,500 of the legal fees was deductible in 1927, then the Board erred in failing to hold that all of the other items of income should have been

Thus, it is not deemed necessary to answer all of the arguments advanced in petitioner's brief or to discuss all of the cases therein referred to in support of his claim that he was entitled to the deduction of the entire \$20,000 in 1927. Such a discussion is wholly beside the point. The issue of the right to a deduction of the entire \$20,000 in 1927 was not raised in the Board of Tax Appeals, and is not therefore properly before the Court. The Circuit Courts of Appeals have generally held that they will not pass upon an issue not presented to the Board. *Glassell v. Commissioner*, 42 F. (2d) 653 (C. C. A. 5th); *Atkins' Estate v. Lucas*, 36 F. (2d) 611 (App. D. C.); *Jeffery v. Commissioner*, 62 F. (2d) 661 (C. C. A. 6th). It is fundamental that a party litigant must recover, if at all, on the causes of action stated in his pleadings. *Atlantic Casket Co. v. Rose*, 22 F. (2d) 800 (C. C. A. 5th). A party cannot set up additional causes of action on appeal. *Bankers Coal Co. v. Burnet*, 287 U. S. 308. It has been repeatedly stated that a question not raised below, nor assigned as error, is not properly before the Court on review. *Blair v. Oesterlein Co.*, 275 U. S. 220, 225; *Magruder v. Drury*, 235 U. S. 106, 113. Issues are framed before the Board of Tax Appeals as well as other tribunals by pleadings, and issues not litigated be-

placed on the cash basis. The petitioner did not before the Board claim that they should, and there is therefore no merit to such claim, when raised for the first time on appeal to the Court.

fore the Board cannot be litigated before this Court on appeal. See *Moise v. Burnet*, 52 F. (2d) 1071 (C. C. A. 9th).

In addition to the foregoing, it is submitted that the decision of the Board should be upheld on another ground, *i. e.*, equitable estoppel, or estoppel *in pais*, which we will now discuss but briefly. Although he had made returns of his income on the accrual basis for years, the petitioner, having treated this item of legal fees on the cash basis, and having accrued and deducted only the amounts paid respectively in the years 1927 and 1928, and having accepted the benefits of the decision of the Board allowing him the deduction of \$3,500 paid in 1928 and \$6,500 paid in 1929, should now be estopped from claiming the deduction of the entire \$20,000 in 1927. The record before this Court shows that he has sought by his return and obtained by the Board's decision the deduction of \$3,500 and \$6,500 in 1928 and 1929, respectively, in addition to \$3,500 sought and obtained for the year 1927. To uphold the claim raised in his present appeal to this Court and to allow him to deduct the entire \$20,000 in the year 1927, would result in allowing him the deduction of thousands of dollars more than the amount of legal fees fixed by the contract. Having departed from the accrual basis as to this item and having employed the cash basis as to it, and having sought and obtained deductions for the amounts paid in 1928 and 1929, the taxpayer cannot now, at

his election, change his position and go back now to the accrual basis and accrue the entire amount in 1927, especially while he retains the benefits of the deductions allowed him for the years 1928 and 1929 on this item.

The doctrine of equitable estoppel or estoppel *in pais* is so firmly established and has been so frequently applied in tax cases that we refrain from burdening this brief with any detailed discussion of the authorities. *Askin & Marine Co. v. Commissioner*, 66 F. (2d) 776 (C. C. A. 2nd); *Putnam Nat. Bank v. Commissioner*, 50 F. (2d) 158 (C. C. A. 5th); *Ramsey v. Commissioner*, 26 B. T. A. 277, affirmed 66 F. (2d) 316 (C. C. A. 10th); *Moran v. Commissioner*, 67 F. (2d) 601 (C. C. A. 1st); *Matern v. Commissioner*, 61 F. (2d) 663 (C. C. A. 9th); *Stearns Co. v. United States*, 291 U. S. 54; *Bothwell v. Commissioner*, 77 F. (2d) 35 (C. C. A. 10th); *Wheelock v. Commissioner*, 77 F. (2d) 474 (C. C. A. 5th); *Commissioner v. Liberty Bank & Trust Co.*, 59 F. (2d) 320 (C. C. A. 6th); *Haag v. Commissioner*, 59 F. (2d) 514 (C. C. A. 7th); *Edward G. Swartz, Inc., v. Commissioner*, 69 F. (2d) 633 (C. C. A. 5th); *Larkin & Doolittle v. United States* (C. C. A. 8th), decided August 15, 1935, not officially reported but found in Vol. 1, Prentice-Hall, 1935, par. 1823.

It might be pointed out before closing that the record contains no statement of evidence, and that, no evidence being presented to this Court, the find-

ings of the Board as hereinbefore set forth cannot be challenged, but must be taken as correct; and, since the Board's decision is supported by the findings, the order of the Board cannot but be affirmed, inasmuch as the new issue presented by the petitioner is not properly before the Court.

CONCLUSION

It is submitted that the decision of the Board of Tax Appeals should be affirmed.

Respectfully submitted.

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SEPTEMBER 1935. EL